State of Montana

Marc Racicot, Governor

Department of Revenue
Mick Robinson, Director

Natural Resource and
Corporation Tax Division

March 15, 1996

Attn: David S. Guzy
Minerals Management Service
Royalty Management Program
Rules and Procedures Staff
Denver Federal Center, Building 85
P. O. Box 25165, MS 3101
Denver, CO 80225-0165

RE: Advance Notice of Proposed Rule (ANPR)
Valuation of Oil from Federal and Indian Leases
60 Federal Register 65610, dated December 20, 1995

Dear Mr. Guzy:

The State of Montana appreciates being given an opportunity to provide the following comments.

Discussion of Specific Topics

Topic Area: One set of regulations dealing with production from or allocated to Federal and Indian leases, or a separate set of regulations for each

MMS apparently believes that it has a greater obligation to ensure that Indians receive the maximum benefits from mineral resources on their lands than it has toward federal lands. MMS refers to this as "trust obligation." Montana is not convinced that MMS has a *greater* responsibility with regard to Indian lands than it has with regard to public lands. Rather, Montana believes that MMS has an equal responsibility in assuring that it serves the best interests of the general public in its management and collection of royalties from public lands just as it does toward the protection of the interests of Indian tribes.

Therefore, Montana believes one set of regulations would sufficiently satisfy MMS's mandates with regard to both types of leases.

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Topic Area: Oil Posted Prices as a means of capturing market value

A significant amount of evidence has been compiled which demonstrates that while field posted prices may have been representative of market value as recently as the 1980s, this is no longer the case. Evidence consists of findings by consultants, litigation brought by states and other royalty owners against producers, payments above and beyond field posted prices by certain producers, and the prevalence of premiums or bonuses over the field posted prices in true arm's-length transactions. Montana is convinced that field posted prices for oil production have little relationship to what oil is actually bought and sold for and does not believe they should be used to establish royalty value.

Topic Area: How the crude oil market operates today

At this point, Montana does not have clear evidence on how the crude oil market for Montana production operates today, nor how crude oil values that properly represent market value ought to be established. It does have clear evidence that the oil market does not operate as it has historically. Therefore, Montana strongly supports STRAC's recommendation in response to this ANPR that empirical evidence be gathered, either through audits or the hiring of consultants, but preferably both, in order to determine how market value is being established and whether the prevalent methods would be applicable to all oil production on Federal and Indian lands or whether such value should be established regionally.

Topic Area: How oil posted prices typically factor into buy/sell agreements or exchanges

Montana believes that buy/sell agreements or exchanges establish only the cost of transportation and are not reflective of the value of oil sold at arm's-length. Parties who set such prices are not negotiating the first (or field) price with opposing economic interests. Therefore, these types of arrangements should not be relied upon when establishing value for royalty purposes.

Topic Area: Significant Quantities

The concept of "significant quantities," built into existing benchmarks, is the function of a field pricing scheme. It was needed to assure that a small volume of oil did not set value for the rest of the production from a specific field or area. Evidence shows that oil is being marketed regionally and globally, with much of the trading occurring in a few spot markets. The field pricing scheme is outdated. Therefore, the "significant quantities" concept may no longer be relevant in the valuation of oil for royalty purposes.

Recommendations

Montana concurs with STRAC with regard to its recommendations for action on regulatory reform to address the changing oil market. Montana does not support the formation of another negotiated rule until MMS first performs studies and audits of the existing environment. MMS must have facts at its disposal before making critical decisions.

Specifically, Montana concurs that MMS should provide policy guidance to address buy/sell agreements and exchanges. MMS should also provide policy guidance on "significant quantities," if it believes these remain relevant to valuation of crude oil from Federal and Indian lands. In addition, Montana believes that it is in the best interests of the public and Indian tribes for MMS to create an interim regulation that is more efficient than analyzing and discarding benchmarks which reference field posted prices. This interim rule should incorporate the best available indicators of market value as a temporary measure to assure proper values are being assigned for royalty purposes. This interim rule should only be in place until MMS has had the opportunities to fully explore the oil marketplace and draw specific conclusions on important adjustments such as those for regional markets and location differentials. Once MMS has fully investigated market conditions, it should publish a final rule.

This concludes our comments on the ANPR, but we would be pleased to work with MMS to perform audits, gather information, and if and when the time is right, participate in developing a final rule. Please call me at (406) 444-2441 if you have any questions.

Sincerely,

Don Hoffman, Bureau Chief
Natural Resource Bureau